

Child Care Rate Study

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EXECUTIVE SUMMARY

Background

The Department of Social and Health Services (DSHS) sets child care subsidy rates on a regional basis to provide equal access to subsidy recipients throughout the state. The core of the process is a survey of child care providers conducted on a biennial basis. The Office of Financial Management (OFM) was directed to conduct a study of this process in the 1999-2001 supplemental operating budget. The research work was carried out by Washington State University's Social and Economic Sciences Research Center under an interagency agreement with OFM.

Conclusions

The DSHS survey process is accurately capturing market prices for child care. This conclusion is based on extensive comparisons of the DSHS survey data with similar data collected and maintained by Child Care Resource and Referral Centers. Comparison with national inflation rates for child care also speaks for the accuracy of the DSHS survey process. In addition, because of the way the survey results are used, any bias in reported prices would have to vary from region to region to have any real impact on subsidy rates.

Child care prices vary throughout the state largely because of varying costs for facilities and labor. This conclusion is based on an analysis of the cost data provided by survey respondents and cost data gathered from external sources. A formal statistical model was developed to support this conclusion.

There is no evidence that DSHS subsidy rates have a significant impact on the market prices for child care. This conclusion is based on a detailed statistical examination of the relationship between DSHS rate changes and subsequent revisions of prices by providers.

The presence of DSHS as a payer has multiple impacts on the child care market. DSHS subsidies make child care affordable to some families with very low incomes. DSHS subsidy recipients increased from 16 percent to 19 percent of the market between 1992 and 1998. However, this increased market share took place coincident with expanded eligibility. Therefore, the added DSHS market share likely includes many families who would have paid for child care without assistance. Moreover, the total expansion in the number of licensed slots during this time period was three times as large as the increase in DSHS subsidy recipients. Economic theory tells us that without the funds provided by the DSHS subsidy system, there would be fewer child care slots available and the price of child care would be lower.

A lower level of geography could be used as the basis of rate setting. Currently the rates are set on the basis of the six DSHS administrative regions. Rates based on counties would be the next logical step. This would have the effect of increasing the rates paid in some largely urban counties and correspondingly reducing the rates paid in rural areas. The administrative complexity of this change would need to be examined.

The formal role of “usual and customary” rates in the setting of individual subsidy amounts could be examined. The policy is that the subsidy amount should be based on the lower of a DSHS maximum rate and the provider’s usual and customary rate (WAC 388-165-200). There is clear evidence that this policy is not followed in a significant number of cases. It should be noted that providers are free to change their usual and customary rate at any time.

Future Research Issues

As child care expenditures becomes more fiscally important, continuous and consistent databases might be established for forecasting and policy analysis, as has been done for welfare and medical expenditures.

The supply and demand equilibrium in child care markets could not be studied in this report because of a lack of data. Methods for measurement of this aspect of the child care market could be studied and developed.

Quality of child care and the public role in it remain important issues. However, it is not clear what the efficient policies are for achieving change in this area, or that the public subsidy rate setting process is a key component in those policies. Experiments, evaluations and studies of quality initiatives are underway in Washington and other states and should be followed.

Child Care Rate Study

METHODOLOGY & OVERVIEW

Introduction

In recent years, the child care market has gained increased attention. Issues such as quality of care, availability of care, and affordability have become important issues across the nation as well as in Washington State. Recently, care has become a critical need for working families due to the combination of a high labor demand from sustained economic growth and years of welfare reform.

The Department of Social and Health Services (DSHS) has attempted to address these needs through various programs designed to support working families. DSHS subsidizes child care for children whose families meet income eligibility guidelines.¹ At present, Washington State subsidizes child care costs for about 20 percent of children in licensed care. Providers are paid by DSHS and may receive amounts up to a maximum rate. The rate is determined by a survey, conducted every two years, that analyzes prices in the child care market.

In recent months, DSHS monthly expenditures for regular non-residential child care subsidies surpassed DSHS monthly expenditures for Temporary Assistance for Needy Families (TANF) grants. The rise in the role and financial commitment of the state in child care has resulted in increased attention to the technical management of payments to child care providers. In addition, many providers have concerns about the regional differences in rates and insufficient payment levels.

The Washington State Legislature began to address these issues in the 2000 legislative session. The 2000 supplemental operating budget² required the Office of Financial Management (OFM) to study child care rates and rate setting and to provide a report to the Legislature.

This report, in response to the Legislature, analyzes aspects of DSHS' child care rate setting system. This system is used by DSHS child care subsidy programs to establish specific rates for age groups and types of licensed providers across the six administrative regions. The first two sections of the report outline the study methodology and present an overview of child care in Washington State. The subsequent three sections address key study areas:

¹ The same rate schedule and payment methods are applied to several smaller programs for special populations run by the Children's Administration.

² Engrossed House Bill 2487 Section 208, (DSHS budget)

- Evaluation of the relationship between DSHS rate setting and rate structure with the general child care market.
- Causes of geographic differences in child care prices and rates.
- Alternatives to the current system of rate setting.

Finally, recommendations for further study conclude the report.

Methodology and Boundaries

Early in the process of preparing this report, OFM staff consulted with the fiscal committee staff from both Houses of the Legislature and developed a list of potential research questions. Those questions were grouped into the three areas that form the core of this report. Below is a brief overview of the data and research methods, along with a list of topics related to child care that are not addressed in this report.

Data and analyses

The data used in this report include:

- DSHS data on payments to child care providers.
- DSHS child care survey data from 1994, 1996, and 1998.
- Operating cost information from 17 providers, primarily in King County.
- Regional economic data.
- Child Care Resource and Referral (CCR&R) data on providers prices.
- National inflation rate data.
- Commercial data on housing costs (Economic Research Institute).

The following techniques were used to analyze the data:

- Correlation analysis was used to determine the relationship between prices measured by the DSHS survey and those measured by CCR&R.
- Regression analysis was used to determine the consistency over time of both the DSHS survey price data and CCR&R price data.
- A correlation test was used to determine whether there was a relationship between the DSHS rate increases and increases in child care prices.
- A least squares regression model was used to determine the major factors influencing prices.
- A comparison table was produced to assess actual DSHS region rates and projected county rates.

Limitations

This report focuses on DSHS child care subsidies, geographic differences in care prices and rates, and alternatives to the current rate setting methods. It does not include some related topics of interest due to time constraints or lack of data; other topics are not addressed because they are not pertinent to the research questions. Topics that are not included in this study include:

- DSHS residential or therapeutic care programs. These types of care are not part of the general market for child care and the agency payment schedule is not determined by the rate setting process.
- DSHS bonus programs, including those for special needs children or infants. These additional payments constitute less than five percent of DSHS child care expenditures. Although rates for some of these payments are affected by the survey and rate setting process, these payments were not analyzed in detail in this study.
- Supply and demand balance in local child care markets. This could not be modeled due to lack of data.
- Diffuse and delayed effects of DSHS subsidy changes. Longer-term effects could not be measured because no feasible test was found.
- Quantitative analysis of the interaction of prices, rates, and quality of care.
- Analysis of market crowding. Since DSHS purchases nearly 20 percent of the available child care market, questions have been raised about the effect this has on the market. Some believe that, due to welfare reform and other changes which expanded eligibility for subsidized care, DSHS children might be filling so many licensed child care slots that non-subsidized, low-income families might be crowded out of all or part of the market.

Also, this study focuses on specific age – provider categories. There are numerous maximum rates set by DSHS because there are four different age groups³, two types of licensed providers, and full-day and half-day care. Although half-day rates are simply 50 percent of full-day rates, this still results in eight rates for each region. DSHS research indicates that, within an area, the correlation between rates is fairly consistent.

Therefore, for analysis and presentation simplicity, this report concentrates on four rate categories: preschool age (30 months to 5 years) and infants (under 12 months old) in centers and in homes. To narrow the focus, these age groups were selected because the preschool category has the most children and infant care is the most expensive per child. For the most detailed analyses in this report, only preschool age rates for center care were analyzed and presented. This group has the most reliable statistics as it is the largest in terms of numbers of children and dollars. Geographically, some of the analyses focused on two areas (Region 1 [Spokane and 12 other eastern counties] and Region 4 [King County]), which generally capture the range of child care markets in the state.

³ There are age breaks at 12 months, 30 months, and 60 months (or kindergarten).

Definitions

The terms “rates” and “prices” are often used interchangeably. In this report, “prices” will be used for the amount of money a child care provider charges for services. “Rates” will be used for the amount DSHS sets as the maximum payment for subsidized care, including both agency payment and recipient co-payment.

Understanding Child Care in Washington State

How care is provided

There are three primary types of child care settings that the state will subsidize for eligible families. These are:

- *Center Based Child Care.* Children are cared for in group settings (usually 13 or more children). Care is provided in non-residential facilities, such as specially built facilities, offices, schools, or churches. Child care centers may be nonprofit (53 percent), for-profit (44 percent), or Government operated (3 percent).⁴ Nonprofit centers have 501(c)3 status and are thus eligible for grants not available to for-profit centers. In comparison to licensed family homes, centers more often provide employee benefits. Private for-profit centers include those managed by large organizations like Kindercare, Le Petite Academy, and Childtime in addition to owner-operated centers.
- *Family Child Care Homes.* Children are cared for by a provider in the provider’s home. The maximum number of children permitted in such a facility is 12 at one time, including the provider’s own children under 12 years of age (WAC 388-155-190). However, the maximum limit is variable depending on the ages of the children served and the size of the home. Homes also may provide for children of varying ages. Family child care homes are owner operated.
- *Kith and Kin.* Children in this setting are either cared for in the child’s home by a relative or an unrelated person, or cared for by a relative in the home of a relative. This care is unlicensed but a formal criminal background check is required if the provider is paid by state subsidy. (See Appendix A on non-licensed care.)

DSHS licenses center and family home child care providers, who must meet “minimum requirements under licensure” standards specified in the WAC.⁵ Licensing requirements include space, staffing, training, and health/safety standards.

At present, Washington State subsidizes child care costs through DSHS for about 20 percent of children in licensed care. Through a variety of programs, DSHS subsidizes child care for children whose families meet income eligibility guidelines. Parents

⁴ Miller, Marna Geyer and Laura Schrager. 2000. “Licensed Child Care in Washington State: 1998.” Department of Social and Health Services. Report 7.100.

⁵ WAC 388-150 for child care centers and WAC 388-155 for family homes.

receiving subsidies are responsible for a monthly co-payment which is based on their income. DSHS, using maximum rates established by a survey of the child care market, pays providers (up to the maximum) for the eligible children served. The rate setting process described in this report applies only to licensed care providers, and not the rate paid for care by kith and kin.

Along with the basic rates paid for standard care, DSHS makes additional payments to licensed child care providers for infants, children with special needs, or care during non-standard hours, and DSHS assists with initial registration fees (See Appendix B on Special Payments). These additional payments constitute less than five percent of the DSHS child care expenditure.⁶

The rate setting process

In order to determine the payment rate, DSHS conducts a biennial survey of licensed child care providers in Washington State, which provides information on the child care market. For the 1998 survey, about 1,100 of 1,700 centers responded to the survey. For licensed family homes, DSHS drew a stratified random sample of 1,730 eligible homes from approximately 7,900 homes licensed in the state; 1,500 homes responded to the survey. These confidential and voluntary survey responses are not only important to meet federal Health and Human Services (HHS) requirements attached to federal funding for child care (See Appendix C on Federal Regulations), but they also collect important information regarding the number of children cared for at a location, their age, hours in care, and the prices charged by each provider. Other topics are also covered in the survey to assist DSHS in managing and understanding its involvement as both the agency with lead responsibility for regulating and encouraging the child care industry and as a major purchaser of child care. The additional questions cover issues such as staffing, staff education, salaries and benefits, program costs, and hours of operation.

Rates are variable depending not only on the geographical region, but also by the age of the child and the type of facility. Based on the surveys, rate statistics are compiled for each of the six DSHS regions in the state (See Appendix D for a region map). These statistics are then used to distribute the Vendor Rate Increase so that subsidized parents in all parts of the state have roughly equal access to care. The goal is not to set the overall level of provider payment, but to adjust for regional differences in the market and allow parents to access care equally. For example, if the DSHS subsidy rate in Tacoma funds access to about half the child care capacity (“slots” or places for one child) in that area, the rate in other areas of the state should also fund access to about half the slots. Although it fluctuates over time, this is approximately what the system has achieved across the state and over time.

The relationship between rate setting and the state budget process

It is important to understand that the child care budgeting process and child care rate setting are two largely separate processes. The size of the overall budget for child care

⁶ DSHS Research and Data Analysis estimate.

subsidies is a matter of fiscal and eligibility policy determined by DSHS, OFM, the Governor's Office, and the Legislature. The budgetary and policy processes also determine how funds are divided between rate increases and extended eligibility, that is, between price and quantity.

DSHS rates are determined by the outcome of the market survey, as mentioned previously. The survey process undoubtedly provides important benchmark information for the budget process about how fast market rates are rising, but there is no direct or inherent connection between the rate survey and the level of funding provided for child care subsidies.

After the policy process has determined the budget and eligibility rules, DSHS uses the survey information and the technical rate setting process to establish specific rates for each age group, region, and type of licensed provider that fall within the parameters of the budget.

Thus, while the rate setting survey does not determine funding levels, it is important for measuring the need for rate increases, for equitably allocating rate increases (once they have been adopted), and for providing other information about the formal child care system in Washington.

Over the last three biennia, budget and policy have combined to vary the share of the market accessible under the subsidy rate. Specifically, the rates have been set at:

- Nov. 1995: 75% of all places or slots⁷, based on the 1994 survey
- Nov. 1997: 59% of all places or slots, based on the 1996 survey
- Sep. 1998: 74% of all places or slots, based on the 1996 survey
- Nov. 1999: 71% of all places or slots, based on the 1998 survey

However, new rate implementation lags due to the budget process. Rate changes are implemented about 18 months after a survey and rates remain in effect for from one to two years while prices continue to rise. The overall effect has been that the DSHS subsidy rate has typically provided access to about half (50th percentile) of the child care capacity on the market.

In summary, the key point is that the DSHS rate setting process only determines how to distribute available, independently budgeted funds across the state so that all eligible families have the opportunity for equal access to their local child care market.

⁷ This means that a subsidized parent would have access to 75 percent of the available slots in 1995.

Child Care Rate Study

ANALYSES & FINDINGS

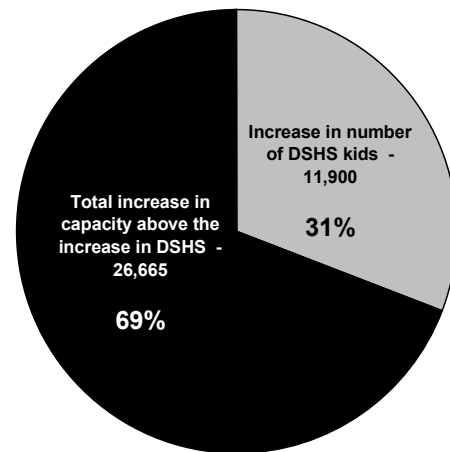
DSHS Rate Setting and the General Child Care Market

Market changes

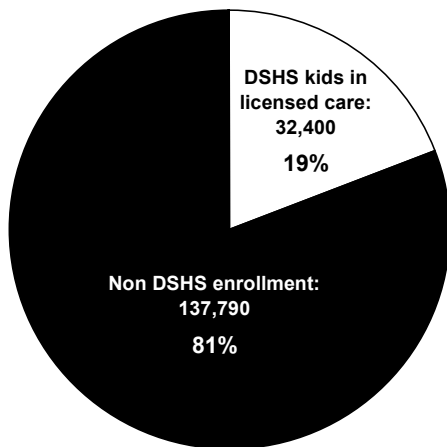
One must first have an understanding of the child care market in order to analyze the role of DSHS rates. In recent years there has been continued growth in the child care industry.

A review of the DSHS survey data from 1992 through 1998 shows that total licensed capacity increased by 38,565 slots while the slots filled using DSHS subsidies increased by 11,900, or approximately 31 percent of the new licensed slots.

DSHS Share of Capacity Increase 1992-98 *Total Increase: 38,565 Slots*



DSHS Share of 1998 Licensed Child Care *Total Increase: 170,190 Slots*

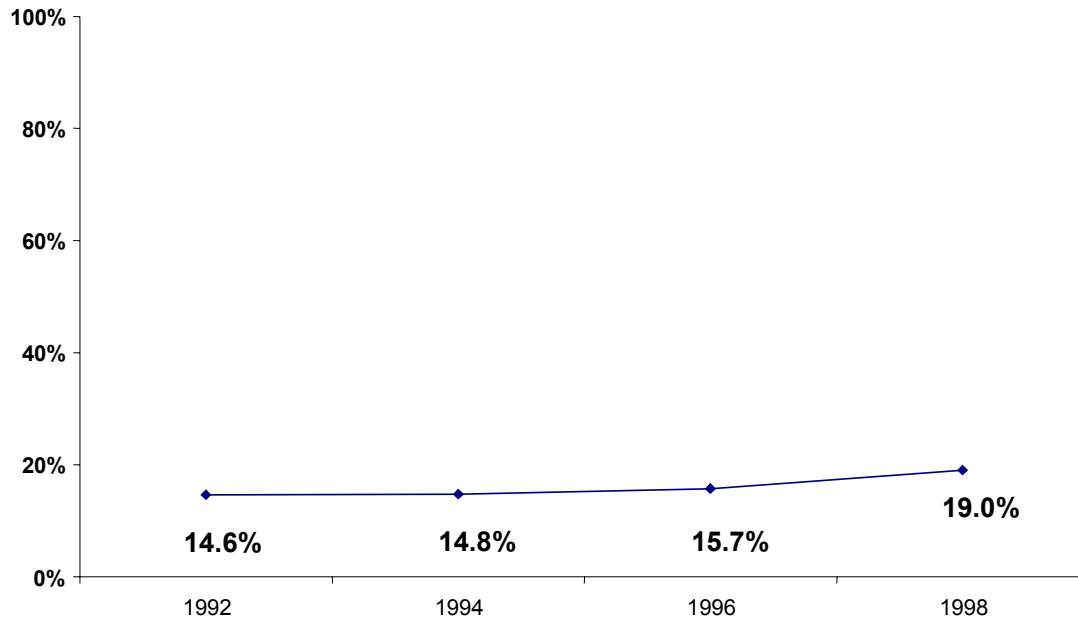


In 1998, about 19 percent of the total licensed capacity was filled by children subsidized by DSHS. While this is an increase from about 15 percent in 1992, the picture is complicated by the expansion of financial eligibility for subsidy and welfare reform. While this is an increase from about 15 percent in 1992, the picture is complicated by the expansion of financial eligibility for subsidy and welfare reform.

Many of those families which were added as DSHS participants would otherwise still have purchased child care, but with more limiting financial constraints in selecting care arrangements. According to DSHS research, many families who were on waiting lists for subsidy programs were purchasing licensed care for their children while they were waiting.

When eligibility was expanded and waiting lists eliminated, these families became part of the subsidy picture.⁸

DSHS Subsidized Children as a Proportion of All Children in Licensed Care



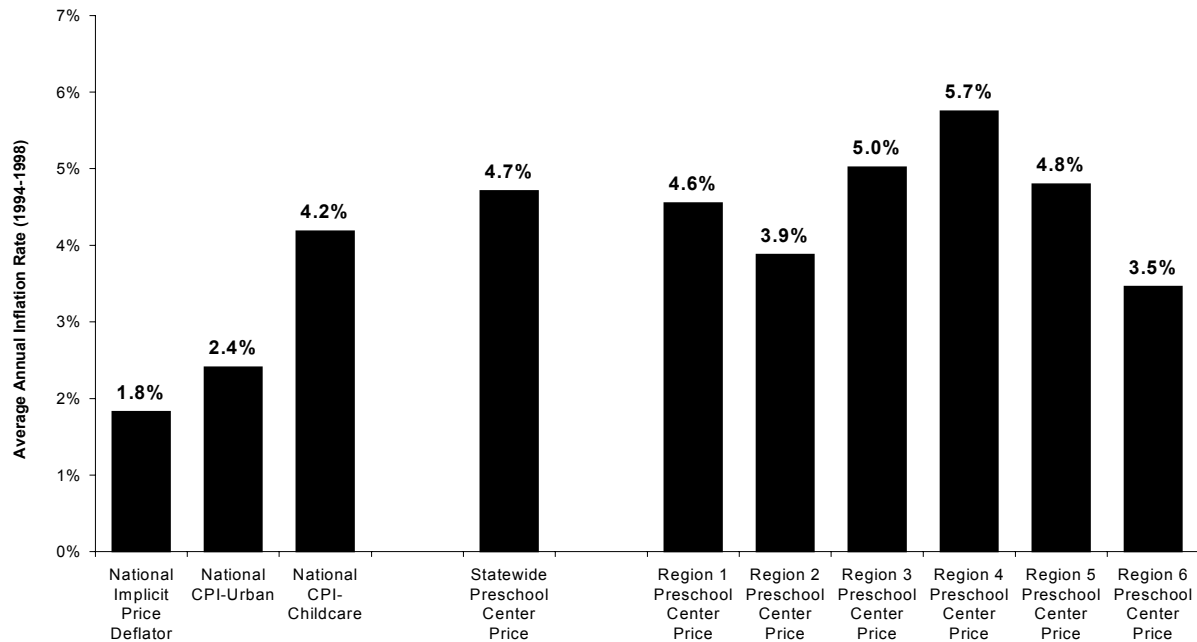
Nationally, inflation in child care prices has been 4.4 percent annually for the years 1994-1998, about twice the general inflation rate. Child care prices in Washington State have been increasing slightly faster, by about half a percentage point per year more than the national child care index.⁹ DSHS rates have been responding to the increases and have been rising as well, although somewhat irregularly due to timing fluctuations in the state budget process.

For preschool age children in centers, the following bar chart illustrates price increases for each DSHS region and the state as a whole, compared with the implicit price deflator, the consumer price index (CPI) for urban areas, and the CPI for the child care market.

⁸ "Short-Term Consequences of Closing Enrollment for Employment Child Care", DSHS Research and Data Analysis, March 1993.

⁹ The Center Preschool rate is used here for illustrative purposes because DSHS subsidizes the most children in this rate category. Overall, inflation in Washington State prices for licensed child care has been similar to the preschool rates illustrated here.

Inflation Rates: National Indices & Median Preschool Child Care Inflation



From this chart, it is clear that prices have been increasing and at somewhat variable rates across regions.

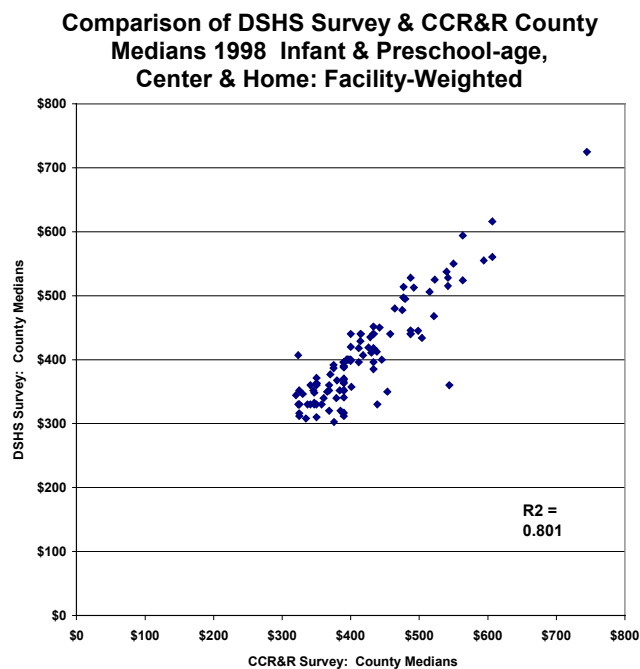
Issue: Does the DSHS survey accurately measure the market?

It has been suggested by some that DSHS rate levels have a significant impact on market prices. There is also a question about whether the DSHS survey accurately measures the market. These two issues will be examined in the following section.

Statistical tests were completed using the DSHS survey data and independent data collected by the state's Child Care Resource and Referral (CCR&R) agencies (See Appendix E on CCR&R). Both of these agencies had information on prices in the child care market.

The graph on the right illustrates the correlation by plotting the CCR&R survey prices on the x-axis and plotting the DSHS survey rates on the y-axis.

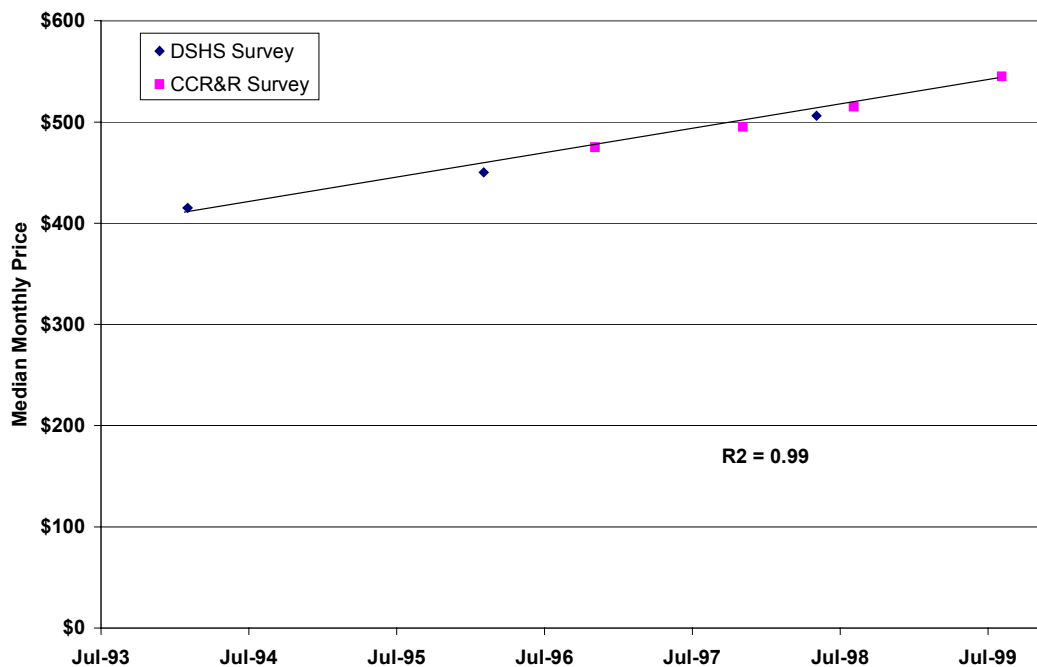
The linear clustering of points ($R^2 = 0.80$) confirms the correlation.



This graph clearly shows that the prices that DSHS measures are very close to the prices that providers report to the CCR&Rs.

Further testing was done by looking at the rates for each region individually. The price data, as measured both by DSHS and CCR&R, were plotted over time and illustrate that the two data types follow the same trend. Statistical regression confirms this association, showing a strong fit of DSHS and CCR&R prices to a single trend line (for each region, R^2 was at least 0.93). The graphs represent full-time preschool age enrollments at care centers. The graph for Region 4 is below; graphs for the other regions are in Appendix F.

Consistency of Median Price Measurement Across DSHS & CCR&R Surveys
Centers in Region 4



Another type of chart was developed to illustrate, across time, the price range for the middle half of providers, as well as the median prices. These charts show CCR&R and DSHS survey price ranges for preschool age children in centers and in family home care in Regions 1 and 4. They are in Appendix G.

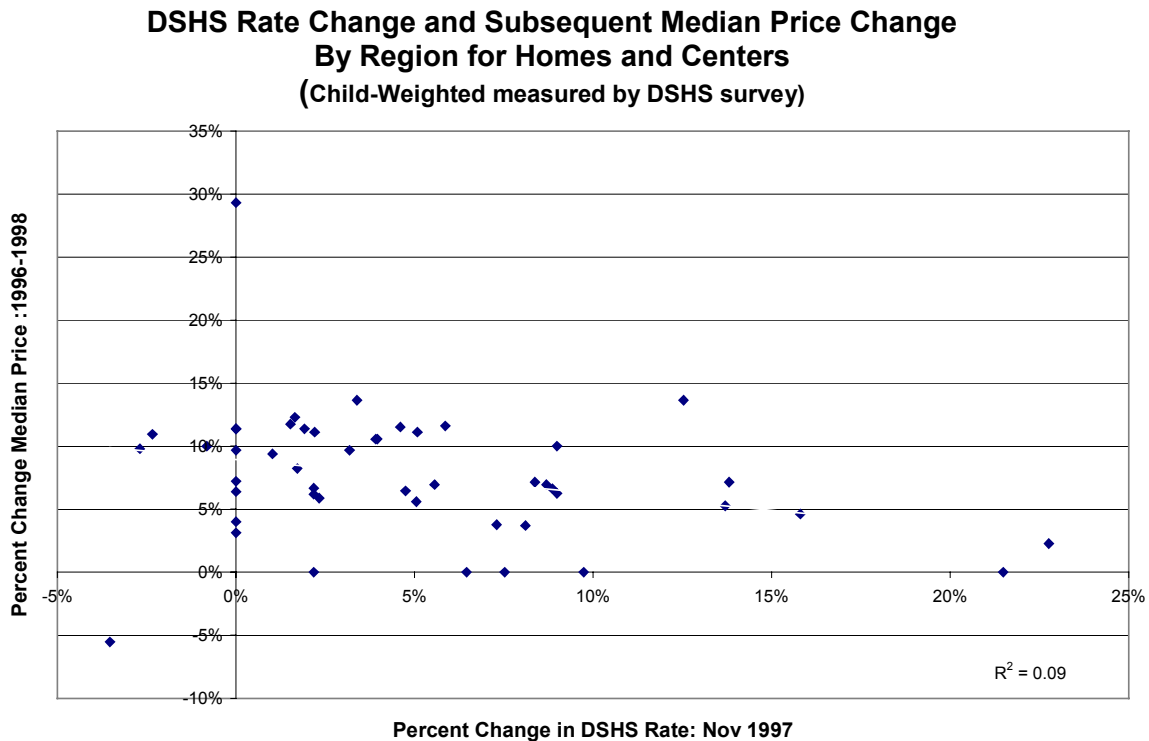
It is important to note that while the DSHS rates are nominally set to reach more than half the market, in reality the payment levels average about half the market (median prices). This is due to a lag (typically about 18 months) between when the surveys are completed and when the rate increase is actually implemented. The rates can then be in effect for up to two years. Therefore, the rates in effect are based on survey data between 18 and 42 months old, depending on the correspondence to the budget cycle. If market prices increase at the same speed in all regions, the lag will not affect equity in access to child care across the state. However, if inflation in market prices is substantially greater in one region than another, equality of access across regions will be impaired by this lag.

Finding

Comparison tests show that the DSHS survey process is accurately capturing market prices for child care. In addition, a comparison with national child care inflation rates also speaks for the accuracy of the DSHS survey process. Finally, because of the way the survey results are used, any inaccuracy in reported prices (reporting bias) would have to vary from region to region to have any real impact on subsidy rates.

Issue: Do DSHS rate levels have a significant impact on market prices?

The effect of DSHS rates on the prices that providers charge is difficult to quantify. If DSHS rates do affect the prices charged by providers, then it would be expected that providers charging low rates would raise their rates toward the DSHS payment maximum. The possibility that the November 1997 DSHS rate increase might have affected child care prices was examined using price changes between the DSHS spring 1996 and spring 1998 surveys. If DSHS rate changes drive the market, then one would expect prices for regions and kinds of care that saw large rate increases in November 1997 would also have large increases between 1996 and 1998. On the other hand, regions and kinds of care that experienced smaller rate changes would be expected to raise their prices by a smaller amount. If the relationship of the market to DSHS rate schedules is strong and short-term, then it should be detectable over a short time period (such as November 1997 / Spring 1998). To assess the correlation, the graph below compares DSHS rate increases to market price increases.



The scattered points on the graph suggest that, in general, higher DSHS rate increases do not necessarily correspond to higher price increases ($R^2 = .09$).

This indicates that there is no apparent correlation between the DSHS rate changes and the corresponding price changes.

No feasible test was found to measure for more diffuse and delayed effects of DSHS rates and subsidies. However, one might make inferences given features of the child care industry. It has characteristics such as low barriers to entry, limited economies of scale, highly localized markets, and significant product variation. Given these, standard economic theory would indicate that some combination of price increases and greater availability of services on the market should result from greater government subsidized purchasing. Although most DSHS subsidy payments buy care near the middle of the price spectrum, there may still be some degree of upward pressure on market prices. However, analysis in this area is complicated by the prevalence of sliding scales and the possibility of subsidies spanning age groups.

Finding

There is no evidence that the DSHS subsidy rates have a significant impact on the market prices for child care. This conclusion is based on a statistical examination of the relationship between DSHS rate changes and subsequent price revisions by providers. The surveys seem to accurately measure market prices, and the DSHS rates do not appear to drive market prices in the short term.

Causes of Geographic Differences in Prices and Rates

Geographic variation

The price of child care varies substantially across the state. The typical pattern shows King County prices to be 50 percent – 70 percent higher than the lowest prices in counties in Eastern Washington. Child care prices vary across the regions and thus DSHS payment rates, which are based on the provider survey, vary as well.¹⁰ With this substantial difference in payment rates, questions about the underlying cause of the difference and the fairness in variation are inevitable. This section will examine what causes the price difference and will analyze whether the current method of determining payment rates is equitable.

Issue: What leads to the substantial child care price variation across the state?

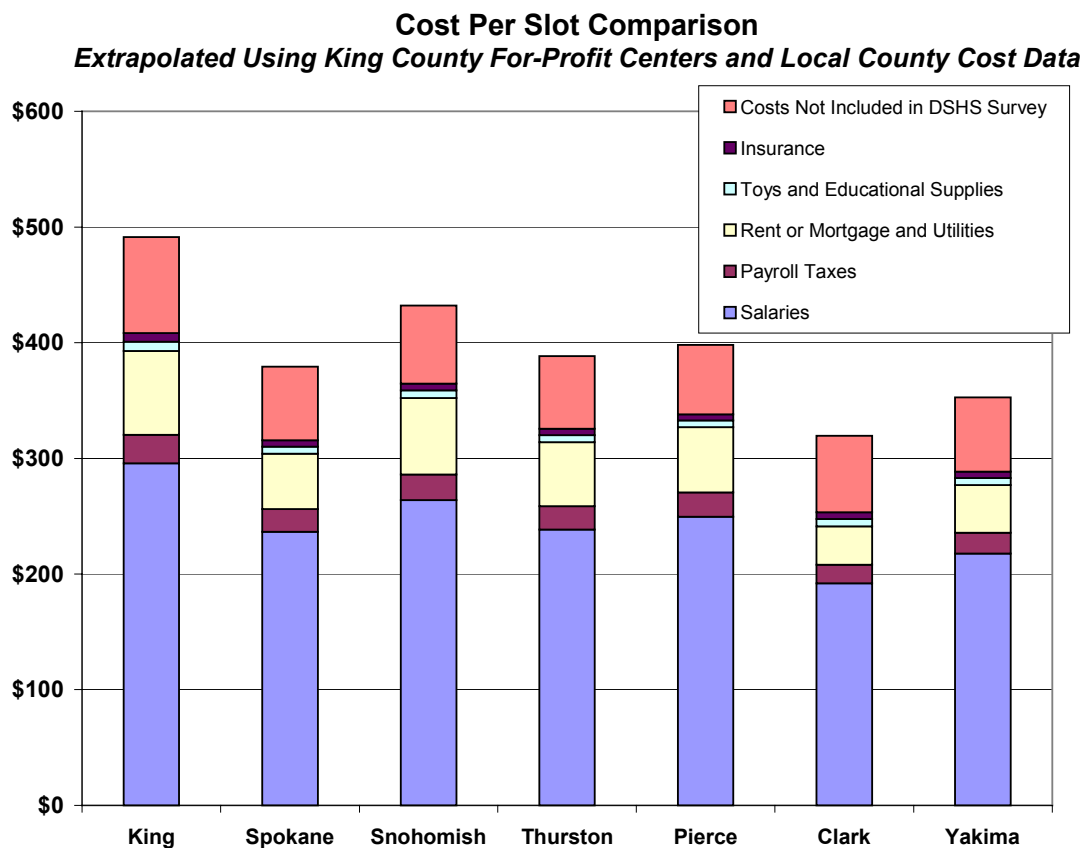
In order to determine what causes the price variation across the state, data were assembled from the DSHS survey, centers that volunteered to assist with the study, OFM, and the Economic Research Institute.¹¹ A formal regression model was developed to examine the statistical connection between provider prices and the county economy. The

¹⁰ The child care market is different from most of the markets in which DSHS pays client service vendors. Unlike most therapeutic and residential services markets, DSHS is not a dominant buyer, and agency staff do not directly interact with the vendor. Nor is the market as structured, credentialed, and regulated as most medical care markets. The type of regional rate setting used in child care is not applied to other DSHS service payments where the market structure and/or agency role are different.

model adjusted for certain characteristics of each provider's operation. Because different care center types may respond differently to various factors, separate models were developed for nonprofit centers, for-profit centers, and family home providers. (See Appendix G for regression output and a table of county-level indicators.)

After accounting for provider operational characteristics such as children's ages and center size, the regression model indicates that the major factors influencing prices were local costs of labor and real estate. At for-profit centers, staff health benefits were also a major cost. These labor and real estate factors, which constitute the majority of operating expenditures, do vary substantially across the state. Thus, knowing the operation characteristics of a provider and using the local costs of labor and real estate as predictors, this model was very effective in explaining the variation in prices across the state.

To illustrate this point, the following chart was created to show the variation in costs for several counties in Washington.



This chart illustrates the regional costs that contribute to child care prices. It is clear that there is variation in salary and rent and, to a lesser degree, in payroll taxes and supply costs.

¹¹ Economic Research Institute, Redmond, WA.

An example can be used to illustrate the point even further. If a for-profit provider in Spokane decided to move her business to King County, she would have to make significant price adjustments in order to handle the increased wages (approximately 25 percent higher), the rise in prevailing real estate prices (about 50 percent higher), and the greater probability of having to provide health insurance in order to recruit staff.¹² It would not be feasible for this provider to maintain the same prices that were charged in Spokane.

It is important to note that the balance of supply and demand in local child care markets could not be modeled due to a lack of data. There were indications that inclusion of supply/demand data might have improved the accuracy of the model, particularly in King and Snohomish Counties.

Finding

The statistical analysis of data has shown that the geographic differences in child care prices are largely due to local costs of labor and real estate. In addition, staff health benefits were a major contributing factor at for-profit centers.

Issue: Do DSHS regional rates deal equitably with variations in child care prices among the counties within administrative regions?

The equity of regional rates (averaging urban and rural counties together) has been questioned, particularly with respect to areas of Eastern Washington. Currently, DSHS has 6 regions (See Appendix D) across the state and pays the same rate to all providers in a given region. Region 1 includes many rural counties as well as Spokane County, which is urban. Thus, a provider operating in the city of Spokane would be paid their usual charges up to the same maximum rate as a provider in rural Garfield or Ferry County. Because some costs in urban areas are higher, some have argued that providers in those settings should be paid at a higher rate.

At one time, DSHS used a more complicated system of setting rates for groups of counties that, although not necessarily geographically adjacent, appeared to have similar price structures. This system was replaced by regional rates in 1994. The reason for this change was to assist with administrative simplicity in the field and to avoid reducing rates to providers as would have inevitably happened in a few cases whenever counties were regrouped. The result of this change to regional rates is to average together counties with urban areas and nearby less populous rural counties.

Many rural counties have too few providers to serve as reliable or stable price measurement or rate setting units. However, most counties with urban areas have enough providers to support separate analysis. The following chart shows what current payment rates for urban counties would be, if counties were not averaged together into regions:

¹² Information on wages and health benefit prevalence is from 1998 DSHS child care survey; real estate costs from Economic Research Institute, Redmond WA.

MAXIMUM MONTHLY RATES BY COUNTY AND REGION (Child Weighted)				
71st Percentile from the DSHS Survey of Child Care Providers, 1998				
County	Center INFANT	Center PRESCHOOL	Home INFANT	Home PRESCHOOL
Region 1	\$500	\$396	\$418	\$374
SPOKANE	\$504	\$385	\$440	\$385
Region 2	\$510	\$390	\$396	\$332
YAKIMA	\$440	\$352	\$352	\$330
BENTON	\$625	\$471	\$440	\$374
FRANKLIN	\$400	\$400	\$352	\$352
WALLA WALLA	\$360	\$320	\$399	\$374
Region 3	\$664	\$484	\$550	\$484
SNOHOMISH	\$664	\$502	\$550	\$484
WHATCOM	\$688	\$427	\$506	\$440
Region 4	\$832	\$575	\$660	\$550
KING	\$832	\$575	\$660	\$550
Region 5	\$568	\$428	\$462	\$418
PIERCE	\$568	\$432	\$440	\$396
KITSAP	\$560	\$395	\$484	\$440
Region 6	\$563	\$440	\$451	\$396
CLARK	\$664	\$462	\$506	\$396
THURSTON	\$535	\$459	\$440	\$440

The chart shows that in most cases, the urban counties “independent” rates would be slightly higher than the regional rates. Given the importance of wage and real estate costs identified in the previous section, it would be surprising if rural areas with lower labor and housing costs did not tend to have lower child care prices. While this is the overall pattern, there are cases that do not fit this trend. For example, if rates were determined for Spokane County independently of the rest of Region 1, center preschool-age rates would be \$11 per month less than the regional rate. It should also be noted that if rates were determined separately for urban counties, rates for the rural counties would be slightly lower on average than the current regional rates.

While the county-specific rates are generally higher for the urban counties than for the regions, the difference in rates is not extreme. In cases in which regional rates are below what county-level rates would be, the regional rates still provide access to at least 60

percent of capacity, as measured by the 1998 survey. The target for the current rates was to equalize access at 71 percent of capacity.

Finding

Examining price data at the county level, it is clear that urban counties' prices are, on average, slightly higher than the regional prices. However, this difference in rates is not extreme, and there are cases in which some prices are higher outside of urban counties. Rates based on regional averages still provide substantial access to the market.

Alternatives to the Current System of Rate Setting

Current federal requirements provide no option for foregoing biennial surveys. 45CFR98.43, as revised October 1999, states:

- “(b) The Lead Agency shall provide a summary of the facts relied on to determine that its payment rates ensure equal access. At a minimum, the summary shall include facts showing:*
- (1) How a choice of the full range of providers, e.g., center, group, family, and in-home care, is made available;*
 - (2) How payment rates are adequate based on a local market rate survey conducted no earlier than two years prior to the effective date of the currently approved Plan;”*

(See Appendix C for details on federal funding.)

While some price information could be gathered as part of the periodic re-licensure process¹³, it would not be feasible to collect all of the information covered in the DSHS biennial survey through licensure staff. The additional workload, the complexity of the information, and the need for confidentiality are all reasons why this is not a feasible option.

While there is no evidence of significant misrepresentation of current prices by providers responding to the survey, questions about this issue have arisen. Given the survey and rate setting methods (using percentiles rather than mean averages), misreporting of prices by a few providers would have very little effect on rate determination. Consideration of alternative methods for collecting price information failed to identify any affordable options likely to generate more reliable data.

There are, however, some alternatives that could improve the process.

- **Using geographic units smaller than the six DSHS administrative regions as rate setting areas.** An option could be that only counties with major urban areas could be

¹³ License renewals require licensure staff visits to centers annually and to family homes once every three years.

separate rate zones, while less urban and smaller counties with fewer providers would be grouped with nearby similar counties. For example, separating the four DSHS regions with more than two counties (i.e. Regions 1, 2, 3, and 6) into urban and non-urban groupings would result in ten rate zones. Unless accompanied by a funding increase, implementation of smaller rate zones would raise some rates while decreasing others. It would achieve greater local accuracy, although rate changes would be more sensitive to survey responses and each provider's reported rate. This rate system would be more complicated than the present system (where most field workers deal only with a single regional rate zone) and would add another level of administrative complexity. It is, therefore, not clear that the gain in local accuracy would offset increased complexity for staff, increased sensitivity to responses in the provider survey, and the potential for more administrative error.

In addition, decisions on which counties would be grouped together would also likely be subject to questions about equity, particularly for those providers in areas seeing relative drops as regions were split up. Review of geographic aspects of other states' child care rate setting systems did not identify a clearly superior alternative.¹⁴

Implementation alternatives

In addition, the process of examining payment data brought to light some minor technical issues in the implementation of rates. These issues affect small portions of total DSHS expenditures on regular child care (about 0.5 percent to 2 percent¹⁵), but they may nonetheless improve the process. The alternatives include:

- **Removing the “usual and customary rate” policy.** The policy is to pay a provider's “usual” price up to the maximum. Most providers used by DSHS parents charge prices near the middle of the local market.¹⁶ The policy is irregularly implemented, saves very little money in return for its administrative complexity, and would not save a large amount of money, if fully implemented. Increased enforcement of the current nominal policy would require additional staff time and attention in order to gain only modest savings.

It has been argued that, through the removal of the “usual and customary rate” policy and the implementation of a simple payment rate, administrative simplification at a small cost would be achieved. It might be argued, though, that it might induce more low-price providers to seek DSHS clients as a means of increasing revenues, decreasing the availability of low-cost spaces available on the private market. However, given the irregular implementation of the current policy, this effect is likely to be small.

¹⁴ South Carolina, New Mexico and Tennessee use rural, urban and suburban boundary definitions. Oregon uses 3 zones based on zip codes. Colorado has separate rates for each county. Maryland combines the rates of the highest income communities with those of the lowest to determine the market rate. Rhode Island surveys providers about subsidies used to offset child care costs.

¹⁵ Data from DSHS 1998 child care survey and DSHS Research and Data Analysis estimates.

¹⁶ Analysis of DSHS payment records (SSPS).

- **Instituting automated reminders to trigger rate adjustments as children grow older.** Currently, the rate schedule calls for children to be moved to progressively lower rates as they grow older or enroll in school, which reflects the general pattern of market prices. Payment data indicate that these changes to lower rate categories often lag months behind the aging or enrollment of the child.¹⁷ Automated reminder systems could be used to improve precision in agency application of the rate schedule.

Child Care Payments by Age of Child



Issues for further study

The following are areas identified for additional study:

- **Establish continuous and consistent databases.** As child care expenditures become more fiscally important, additional continuous and consistent databases could be established for forecasting and policy analysis, as has been done for welfare and medical expenditures.

¹⁷ In many cases, this is probably due to the authorization cycle. Care is authorized in six-month blocks and the age-appropriate rate is set at the beginning of that six months, but often not reviewed until that period has expired. However, there are a significant number of cases to which an inappropriately high rate is applied more than six months after the child has aged into an older category.

- **Study the role of demand for child care in market rates and structure.** Current data do not allow for any meaningful measurement of the supply and demand equilibrium for child care across the state. This is an important issue that would require further study in order to develop an effective method to regularly assess this factor.
- **Study closely the experiments, evaluations and quality initiatives that are underway in Washington and other states.** Quality of child care and the public role in child care remain important issues. However, it is not clear what the efficient policies are for achieving change in this area, and it is far from clear that the public subsidy rate setting process is a key component in those policies.

Child Care Rate Study

CONCLUSIONS

The child care market and the DSHS role have garnered increasing attention. The Washington State Legislature has begun addressing many issues related to child care. This report studied areas that were noted to be of interest, namely:

- The relationship between DSHS rate setting and rate structure with the general child care market.
- The causes of geographic differences in prices and rates.
- Alternatives to the current system of rate setting.

Data were analyzed and statistical tests were run. These studies showed that:

- The DSHS survey accurately measures the market.
- DSHS rates do not have a significant impact on child care market prices.
- Child care price differences are mainly due to local costs of labor and real estate.
- The difference in DSHS payment rates across counties is not extreme, though urban counties' median prices tend to be slightly higher than the regional DSHS median rate. There are cases in which urban county prices are lower than regional average prices.
- Using geographic rate setting areas that are smaller than the six DSHS administrative regions would allow for greater accuracy, but would also add another level of administrative complexity to the current system.
- Removing the “usual and customary rate” policy would provide administrative simplification at a small cost.
- Instituting automated reminder systems as children grow older could improve precision in agency application of the rate schedule.

